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**COORDINATED ISSUE
RETAIL INDUSTRY
DEDUCTION OF CONTRIBUTIONS TO I.R.C. § 401(k) PLANS
ATTRIBUTABLE TO COMPENSATION PAID AFTER YEAR END
UNDER I.R.C. § 404(a)(6)**

FACTS

The corporate taxpayer has a qualified cash or deferred arrangement plan under I.R.C. section 401(k) and provides for matching contributions in accordance with section 401(m). The corporate tax year end is June 30 and the plan year is December 31. By the last day of the plan year, December 31, 19xx, the corporation had contributed amounts to the plan in accordance with the terms of the plan. The contributions consisted of:

1. The elective deferral and matching contributions attributable to compensation earned by plan participants before the end of the corporate year ending 6/30/xx; and
2. The elective deferral and matching contributions attributable to compensation earned after June 30, 19xx.

The corporation obtained an extension for filing its 6/30/xx return to March 15, 19x1. The corporation deducted the entire amount of the elective deferral and matching contributions made to the plan during the plan's 19xx year. The total amount did not exceed the 15 percent of compensation otherwise paid or accrued during the 19xx tax year (in accordance with the limitations under section 404(a)(3)(A)(i)).

QUESTION

Are contributions to a qualified cash or deferred arrangement plan within the meaning of section 401(k) or to a defined contribution plan as matching contributions within section 401(m) deductible by the employer for a specific taxable year, if those contributions are attributable to compensation which was earned by plan participants after the end of such tax year?

LAW

I.R.C. section 404(a) provides that, under certain conditions, contributions to a

qualified plan which are otherwise deductible under Chapter 1 of the Code are deductible under section 404.

I.R.C section 404(a)(6) provides that, for purposes of section 404(a)(3), "a taxpayer shall be deemed to have made a payment on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions)."

A contribution would be deductible in a given taxable year if the taxpayer could show that the contributions would have been deductible under section 404(a), and in turn would have been otherwise deductible under chapter 1 of the Code if the contributions had actually been paid on the last day of such taxable year.

Section 1.404(a)-1(b) of the Income Tax Regulations provides that in the case of contributions that are otherwise deductible under section 162 or 212 in order to be deductible under section 404(a), the contributions must be an ordinary and necessary expense during the taxable year in carrying on a trade or business or for the production of income and must be compensation for services actually rendered. A contribution which is otherwise deductible under section 162 or 212 is deductible under section 404(a) if it is paid or incurred for purposes of those sections, in addition to satisfying the other requirements for deductibility under those sections.

Section 461(a) and Section 1.461-1(a)(2) of the regulations provide that an accrual method taxpayer deducts expenses for the taxable year in which all the events have occurred which determine the fact of liability and the amount thereof can be determined with reasonable accuracy. "No accrual shall be made in any case in which all of the events have not occurred which fix the liability..." (Treasury Regulations 1.461-1(a)(2)). The event of actually performing services would be the event for accrual.

DISCUSSION

The phrase "on account of" which is used in section 404(a)(6) was clarified by Rev. Rul. 76-28, 1976-1 C.B. 106. This ruling (as modified by Rev. Rul. 76-77 1976-1 C.B. 107) states "a taxpayer shall be deemed to have made payment of contributions to a qualified retirement plan on the last day of the preceding taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the income tax return for such taxable year (including extensions thereof.)"

Revenue Ruling 90-105, 1992-2 CB 69 describes the application of section 404(a)(6) regarding the deductibility of contributions to a qualified cash or deferred arrangement under section 401(k) or to a defined contribution plan as matching contributions, where

such contributions are attributable to compensation earned by plan participants after the end of the taxable year. It was determined that contributions are not deductible for a taxable year, if the contributions are attributable to compensation earned after the end of that taxable year.

Rev. Rul. 76-28 interprets section 404(a)(6) regarding the payment of post-year end contributions. Under the present facts, these payments could be deemed to have been made on the last day of the taxable year if the plan treated the payment at the time of receipt in the same manner that the plan would have treated a payment of those same contributions had they instead been received on the last day of the taxpayer's taxable year. However, Rev. Rul. 90-105 states that the plan could not have done so in the case where the contribution is in regard to compensation earned after the taxable year. Compensation cannot be deferred and contributed to a plan as elective deferrals, and matching contributions cannot be made to a plan with respect to such elective deferrals, until the underlying compensation has been earned. Under section 162 or 212 in order to be deductible under section 404(a), the contributions must be an ordinary and necessary expense during the taxable year in carrying on a trade or business or for the production of income and must be compensation for services actually rendered (Treasury Regs. 1.404(a)-1(b)).

When the plan actually received payment of the post-year end contributions, the plan could properly treat the payment as consisting of elective deferral and matching contributions, because the underlying compensation had already been earned.

If the plan had received payments of the post-year end contributions on the last day of the taxable year, the plan could not at that time have properly treated the payment as consisting of elective deferral and matching contributions, because the compensation on which it was based, had not been earned. It would have been necessary to wait six months to determine the amount of compensation actually earned after the end of the taxable year and therefore what portion of the payment could properly be treated as consisting of elective deferral and matching contributions. Therefore, section 404(a)(6) was not satisfied in regard to the post-year end contributions.

The effect of section 404(a)(6) is to deem a payment to have been made on the last day of the preceding taxable year. It does not make a contribution deductible in a year where the contribution couldn't otherwise have been deducted if it had actually been paid on the last day of that year. The purpose of section 404(a)(6) is to provide accrual basis taxpayers a grace period to compute the amount of the contribution due to the difficulty of gathering information about the taxable year by the close of the taxable year. (See S. Rep. No. 1622, 83rd Congress, 2d Sess. 55 (1954).) The "all-events" test was not eliminated under Code Section 404(a)(6). (See Don E. Williams Company v. Commissioner, 429 U.S. 569 (1977)); the section merely extended to accrual basis taxpayers a grace period for the actual payment of the contribution. The Supreme

Court in Don E. Williams Company stated that:

...the words "paid or accrued" or "paid or incurred" appear in many of the Code's deduction provisions. The presence of these phrases reveals Congress' general intent to give full meaning to the accrual system and to allow the accrual-basis taxpayer to deduct appropriate items that accrue, or are incurred, but are unpaid during the taxable year. Section 404(a), however,...stands in obvious contrast. It provides that "if contributions are paid by an employer to... a... profit-sharing... plan, the contributions, subject to a specified limitation in amount, shall be deductible in the taxable year when paid (emphasis supplied). The usual alternative words, "or accrued" or "or incurred," are missing, and their absence indicates congressional intent to permit deductions for profit-sharing plan contributions only to the extent they are actually paid and not merely accrued or incurred during the year. Congress, however, by way of addendum, provided a grace period for the accrual basis taxpayer. Section 404(a)(6) allowed a deduction for the taxable year with respect to a contribution on account of that year if it was a "payment...made" within the time prescribed for filing that year's return.

Rev. Rul. 90-105 determined that contributions to a qualified cash or deferred arrangement plan within the meaning of section 401(k) or to a defined contribution plan as matching contributions within the meaning of Section 401(m) are not deductible by the employer for a taxable year, if the contributions are attributable to compensation earned by plan participants after the end of that taxable year. This conclusion applies regardless of whether section 404(a)(6) "deemed the contributions to have been paid on the last day of the tax year." This section does not provide that the post-year end contributions would be deductible for that tax year. The sole purpose of the section is to provide a grace period for accrual basis taxpayers to compute the amount of the contribution, which is supported by the Supreme Court comments in Don E. Williams Company and the legislative history cited above in House and Senate reports, regarding section 404. In addition, the Treasury Regulations at 1.404(a)-1(b) provide that contributions which are otherwise deductible under section 162 or 212, to be deductible under section 404(a), must be "an ordinary and necessary expense during the taxable year in carrying on a trade or business or for the production of income and must be compensation for services actually rendered." The ruling also applies regardless of whether the employer uses the cash or accrual method of accounting and applies to tax returns filed after 12/6/90.

CONCLUSION

Contributions to a qualified cash or deferred arrangement plan within the meaning of section 401(k) or to a defined contributions plan as matching contributions within section 401(m) are not deductible by the employer for a specific taxable year, if those contributions are attributable to compensation earned by plan participants after the end of such taxable year.